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STATEMENT OF
FREDERICK D. WOLF, DIRECTOR
ACCOUNTING AND FINANCIAL MANAGEMENT DIVISION
BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL FINANCE
AND MONETARY POLICY
OF THE
SENATE COMMITTEE ON BANKING, HOUSING
AND URBAN AFFAIRS
ON THE
FINANCIAL CONDITION OF THE EXPORT-IMPORT BANK
OF THE UNITED STATES

Mr. Chairman and Members of the Subcommittee:

I want to thank you for the opportunity to offer testimony today concerning the financial condition and reporting practices of the Export-Import Bank of the United States (the Bank). GAO annually audits the Bank's financial statements, and we are currently engaged in an audit of the Bank's fiscal year 1985 financial statements. Today, I will discuss the results of our prior audits and our preliminary analysis of the Bank's 1985 financial data.



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As early as 1975, we expressed concern that the Bank's retained earnings were being eroded as a result of the growing amount of loan delinquencies. In April 1983, we went on record before the House Subcommittee on International Trade, Investment and Monetary Policy expressing our concerns about loan delinquencies and the negative interest rate spread. Since fiscal year 1983, we have reported that the Bank's financial statements present a misleading picture of its true financial condition. In our opinion, the Bank's statements do not reflect the losses that are likely to occur due to the probable uncollectibility of a significant portion of the Bank's loans that are owed or guaranteed by foreign governments.

The uncollectibility of loans has taken on increased importance considering that the Bank has been operating at a loss since fiscal year 1982 and will again report a loss for fiscal year 1985. The Bank's retained earnings have eroded due to the negative interest rate spread and, if loan losses were also properly reported, the government's equity would be substantially reduced. The principle of recognizing loan losses in accordance with accepted accounting practices is well established for private financial institutions and should apply equally to government corporations such as the Export-Import Bank. Unfortunately, the consequence of not maintaining adequate loan loss reserves is also well established, as evidenced by the problems of savings and loan institutions, farm credit banks, and the Maritime Administration's shipbuilding fund (MARAD).

THE BANK'S FINANCIAL POSITION

The Bank reported net losses in its fiscal years' 1982, 1983, and 1984 financial statements of \$160, \$247, and \$343 million, respectively. In fiscal year 1985, the Bank will record a larger net operating loss, estimated to be about \$378 million.

The yearly operating losses reported by the Bank result primarily from three sources: (1) the amount by which interest expense exceeds interest revenue, (2) the amount by which the cost of insurance and guarantee claims exceeds insurance premiums and guarantee fees, and (3) administrative expenses. These operating losses have reduced the Bank's retained earnings from \$2.0 billion at September 30, 1982, to \$1.4 billion at September 30, 1984. By far, the largest source of losses reported by the Bank has been the negative interest rate differential. It is expected that the fiscal year 1985 loss will further reduce the Bank's retained earnings to about \$1.1 billion.

This trend of increasingly larger reported losses is only part of the story. The Bank's accounting practices, which do not recognize loan losses, have resulted in retained earnings which are artificially high. The following assessment of delinquent and rescheduled loans, and insurance and guarantee claims that are considered by the Bank as loans, leads to the conclusion that the value of the Bank's loan portfolio is overstated.

First, delinquent loans at September 30, 1982, were reported at \$1.4 billion, or 8.3 percent of total loans receivable. Preliminary data as of September 30, 1985, show delinquent loans will be \$2.8 billion, or 16.3 percent of total loans receivable.

Second, the total amount of loans receivable which had delinquent installments prior to a rescheduling has increased from \$1.2 billion at September 30, 1982, to \$3.4 billion at September 30, 1985. This represents an increase from 7 to 20 percent of total loans receivable. Reschedulings also distort the financial picture in another way since previously recorded but unpaid interest is consolidated into the current debt. Under current Bank accounting practices, this amount is assumed to be fully collectible. The Bank then also records interest on the total amount rescheduled. At September 30, 1984, total interest added to loan principal balances and included in the Bank's retained earnings was \$267.6 million, up from \$125.8 million at September 30, 1982.

The Bank also has recorded as income interest that has become delinquent. The Bank assumes the delinquent interest will be collected and does not provide for any allowance for loss. That delinquent interest at September 30, 1984, was \$278.1 million, up from \$149.0 as of September 30, 1982.

Finally, the Bank operates guarantee and insurance programs. Under these programs, when a borrower defaults on an insured loan and the Bank is obligated to pay a claim, the Bank often treats the claim payment as a loan receivable. The net loans purchased, which are included in loans receivable, more than tripled from \$288.5 million in 1982, to \$984.2 million in 1985.

We consider loans that are currently delinquent, under reschedulings, or recorded as loan purchases to be "problem" debt because they exhibit characteristics that lead to delinquency and ultimate uncollectibility. The total problem debt, as of September 30, 1982, was \$2.1 billion, or 12.7 percent of total loans; by 1984, that problem debt had more than doubled to \$4.7 billion, or 29.3 percent of total loans. These amounts will again increase for fiscal year 1985.

Our attached analysis of the Bank's financial condition indicates that the amount of problem loans is increasing while the Bank's retained earnings is dwindling. At September 30, 1982, problem loans were roughly equal to the Bank's retained earnings. However, by September 30, 1984, problem loans, as a percent of the Bank's retained earnings, had risen to 322 percent. Preliminary estimates indicate problem loans will exceed 400 percent of the Bank's retained earnings as of September 30, 1985.

It is important for me to point out that we are not criticizing the Bank's rescheduling practices; these are policy decisions between the Congress and the Bank. We are concerned, however, that the results of these policies in the financial statements are not appropriately accounted for and fully disclosed.

Fair presentation of loans receivables requires a recognition in the accounts of the diminished value of loans through a charge against current year's income and a corresponding increase in an allowance for loan losses. The Bank has not recognized that its loans are impaired--even when the foreign governments repudiate the debts. The result, in our opinion, is a loan balance which is not fully collectible and, accordingly, is overstated.

The Bank reported retained earnings of \$1.4 billion as of September 30, 1984. If an allowance for estimated loan losses had been provided, we estimate the Bank's retained earnings would decrease by \$1.0 to \$1.5 billion. This would result in a retained earnings of between \$400 million or a deficit of \$100 million, as of September 30, 1984. Admittedly, our approach involves judgment, but determining an allowance for losses, a common practice of financial institutions, is rarely subject to precise measurement.

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In summary, annual operating losses reported by the Bank since 1982 have eroded the government's equity, which was \$2.0 billion in 1982, to about \$1.1 billion in 1985. But these losses do not reflect the full cost of the Bank's operations because the Bank does not recognize the losses inherent in problem loans. By not recognizing the loan losses, the Bank's financial statements overstate annual income (or understate annual losses) and, on a cumulative basis, substantially overstate the government's equity position. The reason the Bank's financial condition should be presented in accordance with accepted accounting practices is to more accurately reflect the cost of its operations.

One significant result of not recognizing loan losses is the potential impact on congressional oversight. As shown on the statements, the Bank's financial position does not appear as severe as it is in reality, and the Congress may be led to make policy decisions that it would not otherwise make were the Bank's true financial condition fairly presented.

GAO ANALYSIS OF
THE FINANCIAL CONDITION OF THE
EXPORT-IMPORT BANK OF THE UNITED STATES
 (ALL AMOUNTS IN MILLIONS)

	(4) (UNAUDITED) FY 85	FY 84	FY 83	FY 82
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LOANS RECEIVABLE	\$16,860	\$17,504	\$16,883	\$16,565
PROBLEM LOANS (1)				
DELINQUENT LOANS	\$2,753	\$2,707	\$1,904	\$1,377
% OF TOTAL LOANS	16.3%	15.5%	11.3%	8.3%
RESCHEDULINGS	\$3,370	\$1,546	\$1,194	\$1,178
% OF TOTAL LOANS	20.0%	8.8%	7.1%	7.1%
LOANS PURCHASED	\$984	\$757	\$397	\$289
% OF TOTAL LOANS	5.8%	4.3%	2.3%	1.7%
TOTAL PROBLEM LOANS (2)	(5)	\$4,663	\$2,654	\$2,098
GROWTH (FY82 BASE)	(5)	222%	126%	100%
REVENUES:				
INTEREST REVENUE	\$1,478	\$1,458	\$1,342	\$1,272
FEES, PREMIUMS & MISC	\$85	\$99	\$82	\$124
EXPENSES:				
INTEREST EXPENSE	\$1,828	\$1,746	\$1,624	\$1,479
NET LOAN WRITE-OFFS (3)	\$5	(\$20)	\$5	\$32
NET CLAIMS PAID (3)	\$78	\$139	\$14	\$25
ADMIN AND OTHER	\$30	\$35	\$27	\$20
NET LOSS	(\$378)	(\$343)	(\$247)	(\$160)
CAPITAL	\$1,000	\$1,000	\$1,000	\$1,000
RETAINED EARNINGS	\$1,072	\$1,450	\$1,792	\$2,040
CAPITAL AND RETAINED EARNINGS	\$2,072	\$2,450	\$2,792	\$3,040
UNREALIZED INTEREST INCOME				
RESCHEDULED	\$394	\$268	\$199	\$126
DELINQUENT	\$315	\$278	\$186	\$149
CAPITAL AND REALIZED EARNINGS	\$1,363	\$1,904	\$2,407	\$2,765
TOTAL PROBLEM LOANS (5)	(5)	\$4,663	\$2,654	\$2,098
AS A % OF RETAINED EARNINGS (5)	(5)	322%	148%	103%
AS A % OF CAP & RETAINED EARN (5)	(5)	190%	95%	69%
AS A % OF CAP & REALIZED EARN (5)	(5)	245%	110%	76%

NOTES:

- 1- LOANS THAT EXHIBIT CHARACTERISTICS THAT LEAD TO DELINQUENCY AND ULTIMATE UNCOLLECTIBILITY
- 2- EXCLUDING DOUBLE-COUNTING AMONG CATEGORIES
- 3- INCLUDES "LAKER AIRWAYS" LOSS OF \$50M IN FY82 AND \$35M GAIN IN FY84
- 4- PRELIMINARY FY85 DATA; UNAUDITED
- 5- AMOUNT AND PERCENTS CURRENTLY UNAVAILABLE; WILL INCREASE OVER FY84

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